

STATE OF CALIFORNIA



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No. 78/169

September 29, 1978

TO COUNTY ASSESSORS:

POSSESSORY INTEREST VALUATION PROCEDURES

Here is another in the series of letters concerning the implementation of Article XIII A of the Constitution. The enclosed questions and answers illustrate the proper valuation procedures to be followed when valuing possessory interests.

Please refer any inquiries or additional questions to John McCoy of this division, (916) 445-4982.

Sincerely,

Verne Walton, Chief
Assessment Standards Division

VW:sk
Enclosure

A. QUESTIONS AND ANSWERS PERTAINING TO
POSSESSORY INTEREST VALUATION

1. QUESTION: How is the valuation of a possessory interest with a nine year remaining term which is subleased or assigned in January 1978 processed for the 1978 lien date?

out

ANSWER: Since the term of the contract is less than ten years, the PI will be valued as of the 1975 base year.

EXAMPLE: 1975 economic rent = \$500/month x 12 = \$6,000/year
Capitalization rate = 10% (inclusive of taxes)
P.W. of 1 per period factor @ 10% for 9 years = 5.759
1975 base year value = \$6,000 x 5.759 = \$34,554
1978 taxable value = \$34,554 x 1.0612 (CPI adjustment
2% for 3 years) = \$36,668

2. QUESTION: How would a newly created possessory interest written in January 1978 for a nine-year term be valued for the 1978 lien date?

ANSWER: Possessory interests which are newly created subsequent to March 1, 1975 shall be appraised at their full value as of the date of creation.

EXAMPLE: 1978 economic rent = \$600/month x 12 = \$7,200/year
Capitalization rate = 10% (inclusive of taxes)
P.W. of 1 per period factor @ 10% for 9 years = 5.759
1978 taxable value = \$7,200 x 5.759 = \$41,465

3. QUESTION: How is the valuation of a possessory interest in which a new lease, sublease, renewal, or assignment written for an 11-year term in January 1977 processed for the 1978 lien date?

ANSWER: ~~Since the term of the contract is greater than ten years,~~
the PI will be valued as of the 1977 base year.

EXAMPLE: 1977 economic rent = \$600/month x 12 = \$7,200/year
Capitalization rate = 10% (inclusive of taxes)

P.W. of 1 per period factor @ 10% for 11 years = 6.495

1977 base year value = \$7,200/year x 6.495 = \$46,764

1978 lien date value = \$46,764 x 1.02 (2% for 1 year) = \$47,699

4. QUESTION: How would you handle the valuation of a possessory interest for the 1978 lien date which existed in 1975 in which an addition was added to the existing improvement in February 1976?

ANSWER: Assuming that no change of ownership has occurred to the existing PI, it will be valued as of the 1975 base year whereas the addition would be valued as of the 1976 base year.

EXAMPLE: Term of possession = 20 years

REL of improvements (existing and addition) = 50 years

Cost of addition in 1976 = \$10,000

Capitalization rate = 10% (inclusive of taxes)

1975 base year value of existing PI = \$40,000

1976 base year PI value of addition:

Improvement reversion = $\frac{50 - 20}{50} \times \$10,000 = \$6,000$

P.W. of reversion = \$6,000 x .1486 (P.W. of 1 @ 10% for 20 years) = \$890

PI value of addition = \$10,000 - \$890 = \$9,110

1978 lien date value of existing PI:

\$40,000 x 1.0612 (2% for 3 years) = \$42,448

1978 lien date PI value of addition:

\$9,110 x 1.0404 (2% for 2 years) = \$9,478

Total PI value for 1978 = \$42,448 + \$9,478 = \$51,926

5. QUESTION: How do you determine the taxable value of a possessory interest for the 1978 lien date which was in existence in 1975 on a month-to-month basis at \$150 a month and changed to a three-year lease at twice the original rent in January 1978?

obs

ANSWER: Since the PI was in existence in 1975 and was subsequently renegotiated for less than a ten-year term, it will be valued as of the 1975 base year.

EXAMPLE: (1) Reasonable term of possession in 1975 was two years
(2) Economic rent in 1975 was \$200 per month
(3) Capitalization rate in 1975 was 10% (inclusive of taxes)
(4) P.W. 1 per period factor for 10% for 2 years = 1.736

1975 base year value = \$200/month x 12 = \$2,400/year
= \$2,400/year x 1.736 = \$4,166

1978 lien date value = \$4,166 x 1.0612 (2% for 3 years)
= \$4,420

6. QUESTION: How would you value a possessory interest in pollution control equipment for the 1978 lien date which was in existence March 1, 1975 and which has not experienced a change of ownership subsequent to that time?

ANSWER: If the pollution control equipment is classified as real property, the full value of the possessory interest would be ascertained as of the 1975 lien date and factored forward to the 1978 lien date. If the pollution control equipment is classified as personal property, the taxable value would be determined annually in accordance with the treatment of all personal property.

7. QUESTION: How do you value a possessory interest for March 1, 1978 which was written for a term of five years in January 1975 and will expire at the end of the contract term?

obs

ANSWER: Since the contract will expire at the end of the lease and will not be renewed, it will retain its 1975 base year value and be adjusted annually by 2 percent until its termination.

EXAMPLE: (1) Contract term = 5 years
(2) Economic rent in 1975 = \$200 per month or \$2,400 per year
(3) Capitalization rate = 10% (inclusive of taxes)
(4) P.W. 1 per period factor for 10% for 5 years = 3.79
1975 base year value = \$2,400/year x 3.79 = \$9,096
1978 lien date value = \$9,096 x 1.0612 (2% for 3 years) = \$9,652

8. QUESTION: Should you consider any options included in the contract when calculating the length of the lease to determine if the period exceeds ten years and constitutes a "change of ownership"?

ANSWER: Options should be included when establishing the base year if there is a reasonable probability that the options will be exercised. Once the base year is established, a reasonable anticipated term should be used for actual valuation.

EXAMPLE: A PI lease written in February 1978 for a six-year term plus a five-year option will have a 1978 base year.